Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Business Data Services in an Internet Protocol	)	
Environment	)	WC Docket No. 16-143
	)	
Special Access for Price Cap Local Exchange	)	WC Docket No. 05-25
Carriers	)	

COMMENTS OF HAWAIIAN TELCOM, INC.

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SUMMARY

Over ten years of investigation and the most burdensome data request ever undertaken in an FCC rulemaking have failed to produce evidence justifying reregulation of ILEC special access services, now renamed business data services. The Commission has taken a serious misstep by issuing the *BDS FNPRM* and should reverse course. Not only does the FCC ignore the competitive evidence in the record, it arbitrarily narrowly defines "the market" to justify reregulation of business Internet services even though the Commission adamantly refused to adopt rate regulation for residential Internet services. The Commission leaps to regulate previously forborne Ethernet services, even though the record shows substantial competitor provision of IP-based services. And all of the Commission's conclusions are based on outdated and flawed data as competition for business data services is already intense and continues to grow. The FCC should terminate this proceeding and declare victory in its pursuit of "competition, competition, competition."

Competition is flourishing. Multiple and well-heeled wireline communications companies continue to invest billions of dollars to provide services in competition with price cap ILEC business broadband services, including business data services. These companies provide service utilizing fiber and other high-bandwidth facilities. The availability of such services and new technologies, such as Internet protocol ("IP") and DOCSIS 3.0, have grown exponentially over time. These competitors are not hindered by the manner in which Hawaiian Telcom provides traditional special access services under current pricing flexibility regulations or forborne Ethernet services. The FCC is incorrect that there is insufficient elasticity of demand between business data services and best efforts services. Best efforts services should be considered part of the business data services market.

Geographic scope of market definition. The Commission's contract economist supports the fact that competitors will build to distant locations of up to half a mile. Therefore, building-by-building and census block and tract geographic area analyses are incorrect, because market facts show that competitors will build to new buildings located near their current facilities. Based on the actual deployment of competitive facilities, the Commission should evaluate pricing flexibility claims based on an area larger than census tracts where competitors are likely to provide service and which are administrable.

Number of competitors in market. The Commission should conclude that the presence of two competitors, including ILECs, CLECs, or cable providers, particularly if they are facilities-based, is sufficient to constrain pricing in a market. This conclusion is consistent with the Rysman finding that prices tend to be lower in Phase I and Phase II pricing flexibility markets, where the number of competitors is not as important as the presence of irreversible sunk investment. Given the business clientele to which services are being sold, there is no reason to require a greater number of competitors to demonstrate effective competitive pricing pressure.

Reregulation Not Proper on This Record. Because the Commission has no facts upon which to conclude that any existing rates are unlawful, there is no lawful way under the Communications Act to invalidate existing prices.

Price cap regulation of special access rates in Phase II markets is inappropriate. The Commission adopted price cap regulation in 1991 when incumbent LECs still had few competitors. As marketplace and competitive forces grew, price cap regulations were substantially changed as the Commission gained more experience with the regulations. These twenty-year-old regulations are now outdated and inappropriate for business special access services offered in competitive markets.

The confluence of market conditions, technological innovation, historical complications, and regulatory trends strongly support avoiding the burdensome and protracted process necessary to develop a new productivity factor, particularly when competitive pressures achieve the same objective in a less intrusive manner. Furthermore, the Commission has affirmatively declined to adopt a service-specific productivity factor for individual services, because the X-factor measured the "LEC industry as a whole."

There is also no basis for reinitializing special access rates. Reinitialization could only occur through further proceedings exploring actual carrier costs and financial data. Reinitialization based on current market conditions would be burdensome and wholly unnecessary and would harm the long-term sustainability of the price cap mechanism.

The Commission should not adopt benchmark pricing for Ethernet prices because the methodologies set forth in the *BDS NPRM* are not supported by precedent or law.

Terms and Conditions. The Commission should resist adoption of prescriptive rules to invalidate special access terms and conditions that would apply throughout the country. "Fresh look," is a rarely used remedy that has been applied only to break a monopoly hold on customers in a newly competitive market. The special access marketplace is not a monopoly market or newly competitive; rather, multiple competitors have provided Internet service connections to businesses for over fifteen years. Contractual termination penalties exist in order to preserve a customer-negotiated beneficial arrangement. Because business Internet connections often involve large up-front costs for providers, and customers insist on paying for service over time, ensuring that contracts continue to be in force is essential to ILEC recovery of the costs of serving a customer.

Forbearance Grants. The Commission does not have the legal authority to modify existing forbearance grants, particularly those "deemed granted" by operation of law. Forbearance grants are governed by Section 10(a) of the Communications Act based on a specific record. Once granted, the Commission cannot simply revoke forbearance. First, the Commission cannot, based on the current rulemaking, legally modify forbearance granted by operation of law, such as the Verizon forbearance grant, based on *Ad Hoc Telecommunications Users Committee v. FCC*. Second, the Commission cannot modify or limit the scope of existing forbearance grants once the original proceeding is final. Third, there is no record basis on which to modify existing grants.

The Commission should not modify pricing regulations in existing pricing flexibility grant MSAs, should not reregulate any business data services, and should further deregulate special access services where competition exists based on a properly defined market.

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Over ten years of investigation and the most burdensome data request ever undertaken in an FCC rulemaking have failed to produce evidence justifying reregulation of ILEC special access services, now renamed business data services. The Commission has taken a serious misstep by issuing the *BDS FNPRM*[1] and should reverse course. Not only does the FCC ignore the competitive evidence in the record, it arbitrarily narrowly defines "the market" to justify reregulation of business Internet services even though the Commission adamantly refused to adopt rate regulation for residential Internet services.[2] What is worse, the Commission proposes to regulate previously forborne Ethernet services, even though the record shows substantial competitor provision of IP-based services.[3] And all the Commission's conclusions are based on outdated and flawed data as competition for business data services continues to grow. The FCC

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1 *Business Data Services in an Internet Protocol Environment*, WC Docket No. 16-143, *et al*., Tariff Investigation Order & Further Notice of Proposed Rulemaking, FCC 16-54 (rel. May 2, 2016) ("*BDS FNPRM*").

2 *Protecting and Promoting the Open Internet*, GN Docket No. 14-28, Report & Order on Remand, Declaratory Ruling, & Order, 30 FCC Rcd 5601 (2015), *aff'd. U.S. Telecom Ass'n. v. FCC*, No. 15-1059 (D.C. Cir. decided Jun. 14, 2016) ("*Open Internet Remand Order*").

3 *BDS FNPRM*, Appendix B, Marc Rysman, Empirics of Business Data Services, Section IV.A.

should terminate this proceeding and declare victory in its pursuit of "competition, competition, competition."

I. PRICE CAP CARRIER BUSINESS DATA SERVICES ARE SUBJECT TO PERVASIVE COMPETITION FROM MULTIPLE FACILITIES-BASED PROVIDERS.

Multiple and well-heeled wireline communications companies continue to invest billions of dollars to provide services in competition with price cap ILEC business broadband services, including business data services.[4] These companies provide service utilizing fiber and high-bandwidth facilities.[5] The availability of such services and new technologies, such as IP and DOCSIS 3.0, have grown rapidly over time. This trend is particularly evident in the State of Hawaii, where Oceanic Time Warner Cable and Level 3, a facilities-based CLEC, as well as a number of other national and local companies, actively build facilities and provide services to business customers in competition with Hawaiian Telcom's special access services. These competitors are not hindered by the manner in which Hawaiian Telcom provides traditional special access services under current pricing flexibility regulations or forborne Ethernet services.[6] The Commission should not adopt its narrow definition of business data services, but

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[4] *See, e.g.*, Comments of United States Telecom, WCB Docket No. 05-25, *et al.,* (filed Jan. 28, 2016) ("US Telecom Comments") .

[5] Compass Lexecon indicates that cable company DOCSIS 3.0 and optical fiber facilities should be treated as competition to special access services. Compass Lexecon, Competitive Analysis of FCC's Special Access Data Collection, WCB Docket No. 05-25, *et al*., § III (dated Jan. 26, 2016) (filed on behalf of Alaska Communications, AT&T Inc., CenturyLink, FairPoint Communications, Frontier Communications, Hawaiian Telcom, and Verizon) ("Compass Lexecon White Paper").

[6] Hawaiian Telcom provides traditional special access services pursuant to FCC-authorized pricing flexibility in some parts of Hawaii. *Petition of Hawaiian Telcom, Inc. for Phase I Pricing Flexibility Pursuant to Section 69.709 of the Commission's Rules*, WCB/Pricing File No. 08-01, 23 FCC Rcd 7856 (Wir. Comp. Bur., 2008); *Petition of Verizon for Pricing Flexibility for Special Access and Dedicated Transport Services*, WCB/Pricing File No. 01-27, 17 FCC Rcd

rather should include all best efforts services, including those based on the DOCSIS 3.0 standard. The FCC is incorrect that there is insufficient elasticity of demand between business data services and best efforts services.[7] Best efforts services should be considered to be part of the business data services market.

When reasonably substitutable products are included in the business data services market, according to Compass Lexecon, based on data the Commission has collected in this proceeding, competition for business data services is "near ubiquitous" and "pervasive."[8] CLECs and cable companies have successfully deployed facilities to the overwhelming majority of census blocks and business establishments in Metropolitan Statistical Areas ("MSAs") where Phase I and II pricing flexibility has been granted and where businesses operate.[9] This is equally true in Honolulu, Hawaii, the main center of business activity where Hawaiian Telcom provides special access services.[10]

As many commenters in this proceeding have demonstrated, competition for business data services is increasing, and is pivoting rapidly away from legacy TDM-based services toward newer and more flexible IP-based services. Customers want these new digital services because of the advantages these new services offer.[11] The lack of market power for analog DS-1 and DS-

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5359 (Wir. Comp. Bur., 2002), and WCB/Pricing File No. 03-10, 18 FCC Rcd 11356 (Wir. Comp. Bur., 2003).

7 *See* record evidence cited in note 12, *infra*.

8 Compass Lexecon White Paper at §§ I.B, II.C.

9 *Id*. at § III.

10 *Id*., Special Access Competition Data Analysis, Competition Tables & Table All-MSA-PEN-C (citing CLEC penetration in Honolulu, Hawaii, which is consistent with nationwide data).

11 US Telecom Comments at 8-23; Comments of Verizon., WC Docket No. 05-25, *et al.*, 7, 20, 32 (filed Jan. 28, 2016) ("Verizon Comments"); Comments of AT&T Inc., WC Docket No. 05-25, *et al.*, 22 (filed Jan. 27, 2016) ("AT&T Comments").

3 services is reinforced by the fact that offerings of these services are declining and customers are replacing these services with Ethernet and other IP-based services,[12] facts which the *BDS FNPRM* notes but fails to correctly credit.[13]

This competitive marketplace effectively protects business and carrier customers and ensures that prices remain just and reasonable. This evidence shows that the Commission's pricing flexibility triggers,[14] though flawed, have nonetheless successfully identified the presence of ever increasing competition. Therefore, there is no reason to rescind the flexibility authorizations previously granted, including in Hawaii. In addition, there is no justification for additional rate regulation of business data services,[15] particularly because pricing regulations can harm competition, as the Commission has previously found.[16] Such regulations would undoubtedly be harmful to consumers in the current marketplace in which price cap ILECs operate. Rather, the current regulatory environment, where volume and term discounts, contract tariffs, elimination of price cap rate structures, and short-notice tariff filings are available, has been enormously favorable to business and carrier customers.

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[12] *See, e.g.* AT&T Comments at 22; Verizon Comments at 11; US Telecom Comments at 7. These competitive services include so-called "best efforts" services because they have a high degree of reliability using modern technology, and customers make the decision whether to use them based on technical characteristics, price, and terms and conditions. Verizon Comments at 20; US Telecom Comments at 20-21.

[13] *BDS FNPRM* at ¶ 81.

[14] 47 C.F.R. §§ 1.774 & 69.701, *et seq*.

[15] Indeed, nothing in this record or in the *BDS FNPRM* demonstrates that business data service pricing is unreasonable under 47 U.S.C. § 201(b).

[16] *See* note 71, *infra*.

In any event, the data collected in this proceeding is already out of date given the fast-paced innovations and changes that characterize the business communications marketplace.[17] The data collected and analyzed is faulty because cable TV providers had previously failed to identify the number of Metronet Ethernet-capable facilities.[18] This data demonstrates that the Rysman report as well as nearly every analysis conducted in the BDS FNPRM is flawed, must be discarded, and the Commission should evaluate anew whether to move forward in this proceeding based on valid marketplace analyses. The Commission should not base policy on outdated and erroneous facts, but rather look at the future dynamics of this marketplace. Indeed, the Commission has wisely noted that it is good public policy to promote the change to a modern IP-based network because it results in "better and faster services for consumers."[19] Reregulation would thus be improper based on this aging record.

II. THE COMMISSION SHOULD NOT UTILIZE SMALL GEOGRAPHIC AREAS TO DETERMINE PRICING FLEXIBILITY.

The FCC's contract economist indicates that effective competition occurs if a competitor has facilities within approximately a quarter to a half mile of customer locations.[20] Based on this

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[17] *See, e.g.*, Verizon Comments at 4; US Telecom Comments at 23-33.

[18] CenturyLink, *et al*., Motion to Strike, WC Docket No. 16-143, *et al*. (dated Jun. 17, 2016). This newly provided information demonstrates the significantly increased competitive availability of cable-TV-provided Metro Ethernet service was not just a "best efforts" service, but was of the type that even the FCC has tentatively concluded should be included in the BDS market. *Id*. at 9-16. Notwithstanding, Hawaiian Telcom continues to believe that "best efforts" services should be included in the BDS market based on elasticity of demand and the growing availability of DOCSIS 3.0 facilities throughout the country, including in Hawaii.

[19] *Technology Transitions*, GN Docket No. 13-5, *et al*., Order, Report & Order & Further Notice of Proposed Rulemaking, Report & Order, Order & Further Notice of Proposed Rulemaking, Proposal for Ongoing Data Initiative, 29 FCC Rcd 1433, ¶¶ 2, 13-14 (2014).

[20] *BDS FNPRM*, Appendix B, at 219. Hawaiian Telcom believes that this estimate is not a market finding, which Rysman describes as "narrative" only based on the varying statements of CLECs, *id*., which are entirely self-serving.

conclusion, the Commission asks whether the geographic area of effective competition should be determined based on an area larger than a census block, but smaller than an MSA.[21]

A building-by-building geographic area analysis is incorrect, because market facts show that competitors will build to new buildings located near their current facilities.[22] Likewise, use of census blocks would not be any more appropriate than a building-by-building approach. Census blocks in business districts tend to be as small as a city block or even a single building or campus of buildings under unified management. This same analysis applies to census tracts, which are an aggregation of some census blocks, which vary significantly in size, but are not on average significantly larger than census blocks.[23] These small areas again have little to do with the ability of a competitor to deploy communications facilities, but are created only for conducting demographic research and statistics.[24] Based on the actual deployment of competitive facilities,[25] the Commission should utilize an area larger than census tracts to evaluate pricing flexibility applications where competitors are likely to provide service and which is administratively workable.

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[21] *Id.* at ¶ 214.

[22] *Id.* at ¶ 289.

[23] The Commission itself indicates that the median size of a census tract is only about 1.5 miles across if the demand is viewed as a circle. *Id.* at ¶ 214. Even the Commission recognizes that there is a material competitive effect even in census tracts. *Id*.

[24] Although census blocks and tracts are used for some purposes with respect to the administration of universal service support provided to price cap carriers, the designation is not used to determine the existence of potential competition, but only the actual presence of competitors. *See, e.g*., *Connect America Fund,* WC Docket No. 10-90, Report & Order, 28 FCC Rcd 7211, ¶ 5 (Wir. Comp. Bur. 2013). No attempt has been made to use such small areas to establish rate regulation because costs have never been collected based on such smaller areas.

[25] Compass Lexecon White Paper at § III.B.

The data in the record based on Commission-provided tables show that the majority of ILEC-only buildings are located very near to the fiber networks of competitive providers. Half of ILEC-only buildings are within 88 feet of the nearest CLEC network and 75 percent are within 456 feet.[26] This is well within the quarter to half a mile distance that Rysman reports that a competitor admits that it is willing to build to in order to serve a new customer.

The Commission originally selected MSAs as an appropriate geographic area in which to seek pricing flexibility in large part to identify areas that are "administratively workable."[27] An area that is larger than a census tract and that meets the administrability goal would be the best formulation of the competitive test the Commission seeks to adopt in this proceeding.

The Commission should not base policy on CLEC assertions under what circumstances they will extend facilities to another building in a city based on their own self-interested economics. These CLEC assertions are simply transparent attempts to hobble competitors in a market and avoid risking their own investment dollars, instead foisting such risk on their ILEC competitors. In order to promote investment incentives, the Commission should conclude that CLECs are capable of extending their own facilities once they have made sunk investment in an area larger than a census tract.

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[26] Letter from Christopher T. Shenk, AT&T, to Marlene H. Dortch, FCC, WC Docket No. 05-25, Second Supplemental Declaration of Mark Israel, Daniel Rubinfeld, and Glenn Woroch, ¶ 5 (filed Apr. 20, 2016).

[27] *Access Charge Reform,* Fifth Report & Order & Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶¶ 71-72 (1999) ("*Pricing Flexibility Order*").

III. TWO COMPETING BUSINESS DATA SERVICE PROVIDERS IN A MARKET IS SUFFICIENT COMPETITION TO CONSTRAIN PRICES.

The Commission seeks comments on what number of competitors is necessary to demonstrate the existence of a competitive market.[28] Two competitors, including ILEC, CLEC, or cable TV provider, are sufficient to constrain pricing in a market, particularly where the competitors are facilities-based.[29] This conclusion is consistent with the Rysman finding that prices tend to be lower in Phase I and Phase II pricing flexibility markets, where the number of competitors is not as important as the presence of irreversible sunk investment in network facilities. Given the sophistication of business clientele to which services are being sold, there is no reason to require a greater number of competitors to demonstrate effective competitive pricing pressure.

IV. THERE ARE NO GROUNDS TO ESTABLISH NEW PRICING REGULATION FOR SPECIAL ACCESS SERVICES.

A. The FCC Cannot Find Existing Rates to Be Unlawful in a Rulemaking Proceeding.

Although comments cite purported market share figures to justify reregulation of business data services, not one comment includes a demonstration that any specific price cap rate is unlawful,[30] and the FCC makes no such finding in the *BDS FNPRM*. Because the Commission

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[28] *BDS FNPRM* at ¶ 294.

[29] This conclusion is consistent with the Commission's decision in the Open Internet Remand Order in which it decided not to regulate rates for residential Internet access services where the vast majority of markets tend to have two large competitors. *Open Internet Remand Order* at ¶ 37.

[30] *See, e.g.*, Comments of Sprint Corp., WC Docket No. 05-25, *et al.*, 2 (filed Jan. 27, 2016) ("Sprint Comments"); Comments of the Ad Hoc Telecommunications Users Committee, WC Docket No. 05-25, *et al.,* 5 (filed Jan. 28, 2016) ("Ad Hoc Comments"). Although the record contains general allegations that "rack rates", i.e., tariffed special access rates, are exorbitant, no rates are specifically named or analyzed. *See, e.g.*, Comments of Windstream Services, LLC, WC Docket No. 05-25, *et al.*, 67 (filed Jan. 27, 2016) ("Windstream Comments"); Sprint

has no facts upon which to conclude that any existing rates are unlawful, there is no lawful way under the Communications Act to invalidate existing prices. For instance, if there is no tariff revision pending, the Commission has only three choices: (1) begin a rate prescription proceeding under Section 205,[31] (2), entertain a complaint under Section 208,[32] or (3) initiate an enforcement proceeding[33] alleging that rates violate a Commission rule or order. Since this proceeding involves none of these alternatives, the Commission is unable to change existing prices in this rulemaking proceeding.

There simply is no basis to revoke or invalidate existing special access rate agreements, whether or not offered pursuant to a form of pricing flexibility.[34] There is also no basis to revoke current grants based on pre-existing pricing triggers.[35]

B. Re-regulating Business Data Services Pricing Based on Price Cap Principles is Inappropriate.

In non-competitive markets where the Commission claims there are no "material competitive effects" the Commission would impose modified price regulation, largely based on price cap rules.[36] The Commission sets forth a number of changes it could hypothetically make

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Comments at 47-50; Comments of XO Communications, LLC on Notice of Proposed Rulemaking, WC Docket No. 05-25, *et al.,* 33-34 & n.137 (filed Jan. 27, 2016) ("XO Comments") (alleges prices in general in pricing flexibility areas are higher than "benchmarks" like UNEs, DSL, or cable modem prices).

[31] 47 U.S.C. § 205.

[32] *Id*., § 208(b).

[33] *E.g.*, pursuant to *id*., §§ 501, *et seq*.

[34] *See* AT&T Comments at 18, *et seq*.; Verizon Comments at 61, *et seq.*; Comments of Alaska Communications, WC Docket No. 05-25, *et al.*, 8 (filed Jan. 28, 2016) ("ACS Comments").

[35] Comments of Hawaiian Telcom, Inc., WC Docket No. 05-25, *et al*., 4-5 (filed Jan. 28, 2016) ("Hawaiian Telcom Comments").

[36] *BDS FNPRM* at ¶¶ 5, 11, 344, *et seq*.

to existing regulation without indicating how such a myriad of changes would interact or affect current pricing.

The Commission adopted price cap regulation in 1991 when ILECs still had few competitors.[37] Price cap regulation replaced the more traditional method of rate regulation, rate-of-return, and was designed to provide incentives that would encourage ILECs to become more efficient, while ensuring that rates remained within a zone of reasonableness.[38] It was established as a transitional mechanism to promote a better reflection of market forces that would eventually obviate the need for rate regulation.[39]

As marketplace and competitive forces grew, price cap regulations were substantially changed as the Commission gained more experience with the regulations. The Commission increased pricing flexibility in 1999, recognizing that competition in the marketplace had been growing.[40] In the *Pricing Flexibility Order*, the Commission eliminated most of the constraints on geographic deaveraging for trunking basket services, including special access services. The Commission also took measured steps to forbear from Title II regulation for broadband special access services, such as for Ethernet, Frame Relay, Cell Relay, and other broadband services utilized by business customers.[41] The Commission has repeatedly acknowledged that competition for special access services has grown faster than competition for switched services.[42]

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[37] *See Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 253 (1990) ("*LEC Price Cap Order*").

[38] *Id.* at ¶¶ 2-4.

[39] *Price Cap Performance Review for Local Exchange Carriers,* First Report and Order, 10 FCC Rcd 8961, ¶¶ 210, *et seq*. (1995) ("*1995 Price Cap Review Order*").

[40] *Pricing Flexibility Order*.

[41] *See, e.g.*, *Petition of the Embarq Local Operating Companies for Forbearance Under 47 USC § 160(c) from Application of Computer Inquiry and Certain Title II Common-Carriage Requirements,* Mem. Opinion & Order, 22 FCC Rcd 19478 (2007); *Petition of AT&T Inc. for*

These twenty year-old regulations are now outdated and inappropriate for business data services offered in competitive markets. Enterprise businesses, which are the focus of flexible pricing for special access services, acquire telecommunications services pursuant to competitive bidding, not from standardized tariff sheets.[43] Competitively requesting bids for services permits customers to seek favorable pricing and individualized custom design of services that meet their particularized needs. General ILEC tariffs are not responsive to modern business needs, and competitors, including CLECs and cable companies, are not shackled by such arbitrary restrictions. There is no longer any justification for one-sided regulations that hinder the ILECs' ability to meet the needs of business customers. In fact, the record supports substantial and further deregulatory efforts.[44] The Commission should deregulate the price-cap ILEC provision of special access services where existing and new competitive triggers are met, based on properly defined markets as indicated previously, and terminate price cap regulation.

1. Revision of X-factor would be inappropriate based on this record.

The FCC seeks comments on whether it should set a new X-factor[45] established in the *CALLS Order*, which is currently set equal to inflation rather than tied to productivity.[46] The confluence of market conditions, historical complications, and regulatory trends strongly

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Forbearance Under 47 USC § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services, Mem. Opinion & Order, 22 FCC Rcd 18705 (2007).

42 *See, e.g., Pricing Flexibility Order* at ¶ 110.

43 AT&T Comments at 6-7; Verizon Comments at 22-23.

44 AT&T Comments at 1; Verizon Comments at 68; ACS Comments at 6.

45 *BDS FNPRM* at ¶ 364.

46 *Access Charge Reform,* Sixth Report & Order, 15 FCC Rcd 12962, ¶ 163 (2000) ("*CALLS Order*").

supports avoiding the burdensome and protracted process necessary to develop a new productivity factor, particularly when competitive pressures achieve the same objective.

Originally, the X-factor was a productivity factor, representing the amount by which ILEC productivity exceeded that of the economy as a whole, and consisted of a component based on historical ILEC industry productivity determined on a company-wide (not service specific) basis plus an additional consumer productivity dividend.[47] Through a somewhat contentious proceeding, the Commission adopted a series of "controversial" X-factors, which were challenged by both sides of the industry with mixed judicial results.[48] Throughout this process, the industry failed to reach consensus as to the proper manner in which to establish or calculate a productivity-based X-factor. In 1999 alone, commenters proposed productivity-based X-factors ranging from 3.71 percent to 11.2 percent.[49]

In choosing to shift away from a productivity factor, the Commission in the *CALLS Order* recognized that the protracted proceedings and uncertainty surrounding the productivity-based X-factor "disrupts business expectations and future investment decisions of both LECs and new entrants."[50] In its place, the Commission adopted a new type of X-factor proposed by the LEC/IXC-backed CALLS Coalition.

Under the CALLS plan, the Commission's X-factor was transformed into a limited transitional mechanism that lowered special access rates for a specified period of time.[51] The

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47 *Special Access Rates for Price Cap Local Exchange Carriers*, Order and Notice of Proposed Rulemaking, WC Docket No. 05-25, 20 FCC Rcd 1994, ¶ 31 (2005) ("*2005 Special Access NPRM*").

48 *See Access Charge Reform,* Order on Remand, 18 FCC Rcd 14976, ¶ 9 (2003).

49 *2005 Special Access NPRM* at ¶ 33.

50 *USTA v. FCC,* 188 F.3d 521, 530 (D.C. Cir. 1999); *CALLS Order* at ¶ 1.

51 *2005 Special Access NPRM* at ¶ 34.

special access X-factor was set at 3.0 percent in 2000, 6.5 percent for the next three years, and equal to inflation starting last year. The use of the same term—X-factor—understates the significant differences in approach adopted by the Commission in the *CALLS Order*. First, the X-factor was no longer tied to industry productivity, but rather is a mathematical mechanism to force rate reductions to specific levels.[52] Second, the policy decision was made to treat special access services differently from other price cap offerings through a separate and distinct special access X-factor. Because "special access faces more significant competition than other access services" the CALLS Coalition questioned whether "continued mandated special access reductions will be necessary."[53] Nonetheless, the fact that a special access-specific X-factor was adopted in the *CALLS Order* does not suggest that it would be possible to craft a new, business-data-service-specific productivity factor.[54] To the contrary, a productivity factor is a company-wide measurement that is not even limited to the interstate jurisdiction.[55] The Commission has affirmatively declined to adopt a service-specific productivity factor for individual services, because the X-factor measured the "LEC industry as a whole."[56] Moreover, there are no externally verifiable methods to establish a productivity factor for a subset of ILEC services.

Lastly, the current X-factor is also not indefinite: under the productivity approach, the X-factor remained in place, subject to updates, in perpetuity.[57] The CALLS Coalition members made the conscious policy decision, subsequently adopted by the Commission, to eliminate any

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[52] *CALLS Order* at ¶ 40.

[53] *Reply Comments of the CALLS Coalition*, CC Docket No. 96-262, at 58 (Dec. 3, 1999).

[54] *2005 Special Access NPRM* at ¶ 37.

[55] *Price Cap Performance Review for Local Exchange Carriers*, Fourth Report & Order, 12 FCC Rcd 16642, ¶ 110 (1997).

[56] *1995 Price Cap Review Order* at ¶ 146.

[57] *CALLS Order* at ¶ 141.

further predetermined reductions in special access services—greater than inflation—starting in 2004 in order to encourage additional investment in those areas remaining under price caps.[58] The continued bona fide need for a pro-investment policy towards areas remaining under price caps, consistent with Section 706 of the 1996 Act, strongly suggests maintaining the current X-factor equal to the inflation rate. The practical effect of the current X-factor is to cap special access rates in real terms. The return to a productivity-based X-factor would likely distort market outcomes, and would also be an administrative and legal quagmire for the Commission and the industry. For all the foregoing reasons, the Commission should reject calls to revise or reestablish the X-factor.

2. There is no record-basis to reinitialize price cap rates.

The Commission seeks comments on whether it should reinitialize price indexes in order to force special access prices down.[59] There is no basis for reinitializing special access rates. Reinitialization based on current market conditions would be burdensome and wholly unnecessary and would harm the long-term sustainability of the price cap mechanism. The Commission has recognized that prior calls for reinitialization of price cap rates to achieve a certain rate of return, or any other benchmark rate, are merely self-serving claims of special access customers.[60] The Commission dismissed prior calls for represcription as a "quarrel fundamentally . . . with price cap regulation."[61]

The original *2005 Special Access NPRM* further cautions against "the risk of reducing price cap LECs' incentives to operate at minimum cost and to innovate under future price cap

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[58] *Ex Parte Presentation of the CALLS Coalition*, CC Docket No. 94-1, at 15 (Mar. 8, 2000).

[59] *BDS FNPRM at* ¶ 403.

[60] *Access Charge Reform*, First Report & Order, 12 FCC Rcd 15982, ¶ 291 (1997).

[61] *See LEC Price Cap Order* at ¶ 221

plans."[62] Rate prescription would jeopardize the overall sustainability of price cap regulation by denying carriers past efficiencies earned and undercutting carriers' future incentives to reduce costs for fear of subsequent forced rate reductions.[63] What is more, any attempt to compare results under price caps to arbitrary accounting cost benchmarks and rates of return wrongly perpetuates cost-plus regulation, and needlessly undermines the legitimacy of price cap regulation. One of the key aspects of price cap regulation is to sever the link between accounting costs and rates. As long as rates are set at or below the cap, carriers are free to earn higher returns through efficiency and cost-cutting measures.[64]

3. The Commission should not adopt its proposal to set Ethernet pricing based on benchmarks.

The Commission proposes to set previous unregulated services, such as forborne Ethernet services, based on "benchmark prices."[65] Hawaiian Telcom opposes any effort to price competitively provided IP-based services based on the price of another service. Such an effort is not based on a recognized method for setting just and reasonable prices under Section 201(b), is unrelated to the cost of providing such services, and thus should be resoundingly rejected.

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62 *2005 Special Access NPRM at* ¶ 67.

63 *Id.* at ¶ 67; *see also Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, Notice of Proposed Rulemaking, Third Report & Order, & Notice of *Inquiry,* 11 FCC Rcd 21354, 21454-55, ¶ 230 (1996).

64 *1995 Price Cap Review Order* at ¶ 28.

65 *BDS FNPRM* at ¶ 422.

V. THERE IS NO JUSTIFICATION FOR ADOPTING RULES REGULATING TERMS AND CONDITIONS OF SPECIAL ACCESS OFFERINGS SUBJECT TO PRICING FLEXBILITY.

The Commission should continue to reject claims that terms and conditions of business data services be modified.[66] Terms and conditions of service offerings provide a host of benefits to customers, including both pricing and reliability benefits, which all competitors must meet to serve business and carrier customers in the marketplace.

A. The FCC has Always Been Cautious About Invalidating Terms and Conditions.

The Commission has very infrequently invalidated customer term or growth discounts as being anticompetitive.[67] These actions have been taken only when competition was in its nascency, and these restrictions have not been adopted for a number of years.[68] In more recent times, when competition is well under way, the Commission has frequently rejected efforts to invalidate existing ILEC customer contracts in order to preserve customer expectations and

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[66] *Id.* at ¶¶ 447, *et seq*. The Commission cannot apply reforms of terms and conditions to carriers not involved in its *Tariff Investigation Order* because they were not part of the record in that proceeding.

[67] *See, e.g*., *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, Report & Order, 6 FCC Rcd 5880, ¶ 151 (1991) ("*800 Number Portability R&O*") (termination liability eliminated for small number of AT&T 800 service contracts to implement 800 number portability); *Expanded Interconnection with Local Telephone Company Facilities Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 91-141, Transport Phase I; CC Docket No. 80-286, Second Report & Order & Third Notice Of Proposed Rulemaking, 8 FCC Rcd 7374, ¶¶ 115, *et. seq*. (1993) (limited certain types of growth discounts for specific transport access services).

[68] The Commission's cautious approach is particularly present in providing customers a "fresh look" to terminate existing ILEC contracts in limited circumstances. *800 Number Portability R&O*, ¶ 151; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Mem. Opinion & Order On Reconsideration**,** 8 FCC Rcd 7341, ¶¶ 12-13 (1993) (expanded interconnection term discounts to implement interstate access competition).

benefits in a competitive market.[69] Even the *Tariff Investigation Order* is somewhat circumspect in its conclusions, even though it apparently takes steps beyond the traditional boundaries of Commission precedent.

CLEC claims that ILEC special access terms and conditions should be invalidated are thinly veiled attempts to give CLECs an advantage in the competitive marketplace rather than offering better deals to customers. Customers negotiate contracts or opt into other arrangements because they include desired pricing and reliability benefits. When the terms of current contracts end, most typically in one to three years, the customer can be expected to engage in a new round of competitive bids. Businesses are extremely adept and accustomed to seeking the most cost-effective communications solution by soliciting competing offers. In competitive markets, businesses determine which offering is best for them, based on all components of the offering, including term, volume commitment, reliability, and price. Such markets cannot fairly be characterized as anticompetitive simply because there is a relatively brief period of time during the term of a contract when the customer is not actively seeking new special access service offerings.[70] The Commission should be cautious about interfering with competitive markets because such action risks sending the wrong signals to the market, and could hinder investment and skew competition in a way that is unfavorable to consumers.[71] In the past, the Commission

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[69] *See, e.g. Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992*, MB Docket No. 05-311, Second Report & Order, 22 FCC Rcd 19633, ¶ 25 (2007).

[70] Compass Lexecon White Paper at § II.B.

[71] *See, e.g., Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended*, CC Docket No. 96-61, Second Report & Order, 11 FCC Rcd 20730, ¶¶ 52, *et seq*. (1996) (tariff and rate regulation of competitive services eliminated to avoid impediments to competition).

has found terms and conditions that are the subject of CLEC complaints to be "permissible and pro-competitive."[72]

B. Fresh Look is not an Appropriate Remedy in the Relatively Mature Market that Includes Special Access Services.

The Commission seeks comment on whether it should invalidate existing contracts or customer term and volume commitments at the customer's option.[73] Such a draconian measure, termed "fresh look," is a rarely used remedy that has been applied only to break a monopoly hold on customers in a newly competitive market.[74] The business data services marketplace is not a monopoly market or newly competitive; rather multiple competitors have served the business communications marketplace for over fifteen years. Customer contracts are typically of relatively short durations, such as one to three years. Because customers routinely seek bids from competitors when they desire new contracts, there are multiple opportunities to "win" customers away from existing companies. Given these facts, there are no "lock-ins", as alleged by CLECs, but only the normal operation of the market in which all competitors must operate. Thus, there is no justification for adopting fresh look for special access services.

Customers of special access services now have an expectation that their contracts are legal, subject only to general contract law. It would be markedly anti-customer to reopen these contracts, possibly leading to price increases and other changes in negotiated terms and

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[72] *See, e.g., Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, Mem. Opinion & Order, 15 FCC Rcd 3953, ¶¶ 384-85 (1999) (termination liabilities for Centrex service found to be reasonable).

[73] *BDS FNPRM* at ¶ 438.

[74] *See* § V.A., *supra*.

conditions. Such a possibility smacks of retroactive rulemaking that is disfavored in the law.[75] The Commission rightfully has been cautious about interfering with private contracts when doing so could undermine investment-backed expectations of the carrier and customers alike.[76] No showing has been made in this proceeding that invalidating existing contracts would not have such an investment-squelching impact.

VI. IT WOULD BE UNLAWFUL FOR THE COMMISSION TO REVOKE FORBEARANCE PREVIOUSLY GRANTED BASED ON THIS RECORD.

The FCC proposes to modify existing forbearance grants with respect to ILEC provision of Ethernet and other packet-based services.[77] Forbearance grants are governed by Section 10(a) of the Communications Act based on a specific record.[78] Grant of forbearance entitles a company to operate free of the forborne statutory or regulations that are the subject of the grant. Once granted, the Commission cannot simply revoke forbearance that has been previously granted.[79]

First, the Commission cannot legally modify forbearance that was granted by operation of law. The statute indicates that a forbearance request can only be denied within a maximum of fifteen months of the filing of the forbearance petition. This time period expired ten years ago. There is substantial doubt that the Commission has any statutory authority to reimpose

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[75] *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 216-25 (1988) (Justice Scalia concurring).

[76] *See, e.g., Promotion of Competitive Networks in Local Telecommunications Markets*, WT Docket No. 99-217, *et. al*, 15 FCC Rcd 22983, ¶ 36 (2000).

[77] *BDS FNPRM* at ¶ 517.

[78] 47 U.S.C. § 160(a).

[79] Although the Commission can adopt rules based on a validly conducted rulemaking proceeding, such rules must be based on an adequate factual and legal record. As indicated in these comments, the record in this proceeding does not support the regulations proposed in the *BDS FNPRM*.

regulations by "reversing" or "modifying" a forbearance grant, particularly when Congress granted the Verizon operating companies' forbearance.[80]

Some have argued that the court in *Ad Hoc Telecommunications Users Committee v. FCC* [81] found that forbearance grants can be "reassessed" by the FCC or Congress. This vague court statement is mere dicta made in the context of evaluating the Commission's general rulemaking powers without the benefit of a full briefing on the issue. In addition, the court did not indicate how a forbearance decision could be "reassessed." The *Ad Hoc* decision is therefore of little use in justifying a reversal based on this rulemaking.

Second, the Commission cannot modify existing forbearance grants once the original proceeding is final. Windstream argues that Verizon's "deemed granted" forbearance covering Ethernet services is limited to services that existed at the time of the grant.[82] That position is incorrect. The "existing service" limitation only applies in those circumstances when a Commission order so limits the grant or the forbearance petition itself is self-limiting. Verizon generically requested forbearance for all IP-based business services, excluding TDM DS1 and DS3 services, and never limited its request to "then-existing services."[83] It would be improper

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[80] On appeal of Verizon's "deemed granted" special access forbearance request, the court denied the appeal because the grant was made by Congress pursuant to statute, and hence was an unreviewable agency action pursuant to 47 U.S.C. § 402(a) or 28 U.S.C. § 2342(1). *Sprint Nextel Corp. v. FCC*, 508 F.3d 1129 (D.C. Cir. 2007). "Congress made the decision in § 160(c) to 'grant' forbearance whenever the Commission 'does not deny' a carrier's petition. When the Commission failed to deny Verizon's forbearance petition within the statutory period, Congress's decision—not the agency's—took effect." *Id.* at 1132.

[81] *Ad Hoc Telecomms. Users Comm. v. FCC*, 572 F.3d 903 (D.C. Cir. 2009).

[82] Windstream Comments at 92.

[83] The passages from Verizon's ex parte filings that Windstream identifies in its comments at 93 did not limit Verizon's forbearance request. Rather, Verizon specifically sought forbearance for "all broadband services;" it described "packet-switched services," and "non-TDM based" optical services as the two general categories of service, and then provided examples of "services

for the Commission to now seek to modify the "deemed granted" forbearance grant based on a comment filed ten years after the initial grant. The "deemed granted" forbearance is governed by the record of that proceeding and is legally final. Whatever ambiguities may exist with respect to that grant cannot now be cured through extra-record dicta.[84]

Third, there is no record basis to modify existing forbearance grants based on the competitiveness of the business data services market. As indicated previously, competitive providers have twice the Ethernet revenue as ILECs in their territory. This is certainly the competitive situation that exists in Hawaii. Thus, there is no record basis to modify the existing forbearance grants.

For all of these reasons, it would be unlawful based on the current record to re-impose regulatory conditions that were previously made inapplicable to the Verizon companies by operation of law or to other ILECs through written forbearance decisions.

VII. CONCLUSION

The record in this proceeding demonstrates that competition in the business data services marketplace (as properly defined) is pervasive and robust. That business services marketplace, of which business data services is only a part, includes new and innovative offerings that are increasingly winning customers away from traditional special access services. Further regulation

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that Verizon offers that qualify under each of these two categories." Letter from Edward Shakin, Verizon, to Marlene Dortch, FCC, WC Docket No. 04-440, 1-2 (filed Feb. 7, 2006). DS1 and DS3 services were excluded. Verizon 's petitions specifically asked for forbearance from regulation of "any of Verizon's broadband services", "the same relief" requested in a BellSouth forbearance petition "for all broadband services that BellSouth does or may offer." Petition of the Verizon Telephone Companies for Forbearance, WC Docket No. 04-440, 2, 24 (filed Dec. 20, 2004).

[84] Therefore, the Commission's extra-record pronouncement in *Petition for AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and* Computer Inquiry *Rules with Respect to Its Broadband Service*, Mem. Opinion & Order, WC Docket No. 06-125, 22 FCC Rcd 18705, ¶ 14 n.59 (2007), lacks any decisional significance.

of those services is not only unwarranted, but would harm customers. It would be unlawful for the Commission to invalidate specific price cap carrier special access rates or terms and conditions because no specific offerings are at issue in this proceeding. Reregulatory steps, such as reimposition of price cap regulation, establishment of a new X-factor, or reinitialization of price cap rates would be inconsistent with prior precedent and harm investment incentives and customer expectations. The Commission should retain the existing pricing flexibility grants, and further deregulate special access services where competition exists, based on properly defined markets.

Respectfully submitted,

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